

Office of the State Auditor

Division of State Audit

Department of Transportation Bismarck, North Dakota

Audit Report for the
Biennium Ended June 30, 2007
Client Code 801

Robert R. Peterson
State Auditor



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Transmittal Letter

April 9, 2008

The Honorable John Hoeven, Governor
Members of the North Dakota Legislative Assembly
Francis Ziegler, Director,

We are pleased to submit this audit of the Department of Transportation for the biennium ended June 30, 2007. This audit resulted from the statutory responsibility of the State Auditor to audit or review each state agency once every two years. The same statute gives the State Auditor the responsibility to determine the contents of these audits.

In determining the contents of the audits of state agencies, the primary consideration was to determine how we could best serve the citizens of the state of North Dakota. Naturally we determined financial accountability should play an important part of these audits. Additionally, operational accountability is addressed whenever possible to increase efficiency and effectiveness of state government.

The senior auditor for this audit was Orlin Bensen, LPA. Al Stroklund, Angela Klubberud, and Rich Fuhrer, CPA were the staff auditors. Fred Ehrhardt, CPA was the audit supervisor and Paul Welk, CPA, was the audit manager. Inquiries or comments relating to this audit may be directed to the audit manager by calling (701) 328-2241. We wish to express our appreciation to Director Ziegler and his staff for the courtesy, cooperation, and assistance they provided to us during this audit.

Respectfully submitted,

Robert R. Peterson
State Auditor

Executive Summary

INTRODUCTION

The North Dakota State Highway Commission was created in 1913. Title 24 of the North Dakota Century Code (NDCC) changed the North Dakota State Highway Commission to the North Dakota Department of Transportation (DOT) during 1989. The DOT is responsible for the construction, maintenance, protection, and control of the highways comprising the state highway system within the state of North Dakota. NDCC section 24-02-37 requires the DOT to spend funds in the following order: 1) maintenance of the state highway system, and 2) the cost of construction and reconstruction in an amount necessary to ensure federal aid available to the state. Funds not expended under (1) or (2) may be spent on state highways for construction, improvement, or maintenance. In addition to the state highway system, NDCC section 39-01-01.1 describes the general responsibilities for Drivers License and Traffic Safety Division and Motor Vehicle Division. The DOT, with the approval of the Public Service Commission, has the authority to qualify the state for rail service assistance under the Railroad Revitalization and Regulatory Reform Act of 1977 (NDCC section 49-17.1-02). In addition, the Governor has designated the director of the DOT to act on his behalf to administer the National Highway Safety Act of 1966 and the director of the DOT serves as a liaison to the State Aeronautics Board.

RESPONSES TO LAFRC AUDIT QUESTIONS

The Legislative Audit and Fiscal Review Committee (LAFRC) requests that certain items be addressed by auditors performing audits of state agencies.

1. What type of opinion was issued on the financial statements?

Financial statements were not prepared by the Department of Transportation in accordance with generally accepted accounting standards so an opinion is not applicable. The agency's transactions were tested and included in the state's basic financial statements on which an unqualified opinion was issued.

2. Was there compliance with statutes, laws, rules, and regulations under which the agency was created and is functioning?

Other than our findings addressing "overspending appropriation authority" (page 21), the Department of Transportation was in compliance with significant statutes, laws, rules, and regulations under which it was created and is functioning.

3. Was internal control adequate and functioning effectively?

Other than our finding addressing the "computer access controls weakness" (page 13), "motor vehicle division bank reconciliation" (page 15), and "internal audit function" (page 16), we determined internal control was adequate.

4. Were there any indications of lack of efficiency in financial operations and management of the agency?

No.

5. Has action been taken on findings and recommendations included in prior audit reports?

The Department of Transportation did not implement one recommendation included in the prior audit report. See commentary on page 24.

6. Was a management letter issued? If so, provide a summary below, including any recommendations and the management responses.

Yes, a management letter was issued and is included on page 25 of this report, along with management's response.

LAFRC AUDIT COMMUNICATIONS

1. Identify any significant changes in accounting policies, any management conflicts of interest, any contingent liabilities, or any significant unusual transactions.

There were no significant changes in accounting policies, no management conflicts of interest were noted, no contingent liabilities were identified or significant unusual transactions.

2. Identify any significant accounting estimates, the process used by management to formulate the accounting estimates, and the basis for the auditor's conclusions regarding the reasonableness of those estimates.

The Department of Transportation's financial statements do not include any significant accounting estimates.

3. Identify any significant audit adjustments.

Significant audit adjustments were not necessary.

4. *Identify any disagreements with management, whether or not resolved to the auditor's satisfaction relating to a financial accounting, reporting, or auditing matter that could be significant to the financial statements.*

None.

5. *Identify any serious difficulties encountered in performing the audit.*

None.

6. *Identify any major issues discussed with management prior to retention.*

This is not applicable for audits conducted by the Office of the State Auditor.

7. *Identify any management consultations with other accountants about auditing and accounting matters.*

None.

8. *Identify any high-risk information technology systems critical to operations based on the auditor's overall assessment of the importance of the system to the agency and its mission, or whether any exceptions identified in the six audit report questions to be addressed by the auditors are directly related to the operations of an information technology system.*

ConnectND Finance, Human Resource Management System (HRMS), Vehicle Registration and Titling System, Drivers License Master File, Construction Automated Records System, Motor Pool Billing, and Motor Carrier Online System are high-risk information technology systems critical to the Department of Transportation.

Background Information

The mission of the North Dakota Department of Transportation (DOT) is to provide a surface transportation system to safely move people and commerce. The Director of the Department of Transportation, Francis Ziedgler, is appointed by the Governor.

Direct delivery of services to the public is provided through the central office located in Bismarck and districts strategically located across the state of North Dakota. The central office and the districts provide maintenance, construction, and improvements to the state's highway system. The DOT has regulatory authority over and provides services related to motor vehicle titling and registration, operator licensing and traffic safety, and motor carriers. In addition, the DOT provides the services relative to the National Highway Safety Act of 1966; with Public Service Commission approval, has the authority to qualify the state for rail service assistance under the Railroad Revitalization and Regulatory Reform act of 1977; and serves as a liaison to the State Aeronautics Board.

The Department of Transportation includes:

- Division of Business Support
 - Division of Engineering
 - Division of Driver and Vehicle Services
-

The DOT provides policy direction and funding for the state's highway system for the construction, maintenance, and repair of highways and other services provided through the Division of Engineering. The Division of Driver and Vehicle Services administers the DOT's regulatory authority over motor vehicle titling and registration, operator licensing and traffic safety, and motor carriers. The Business Support Division provides the employment of human resources, financial management, information technology, legal, and other administrative services. The DOT structure is consistent with NDCC section 24-02-01.4 to fulfill its statutory duties.

The DOT's final budget for the 2005-2007 biennium totals approximately \$970 million. This represents a 22% increase over the 2003-2005 budget. The funding for DOT's 2005-2007 biennium appropriation was entirely from federal and special revenue funds.

More information about the agency can be obtained from the DOT's home page at: www.state.nd.us/dot/.

The agency reports to the Legislative Transportation Committee.

Audit Objectives, Scope, and Methodology

Audit Objectives

The objectives of this audit of the Department of Transportation for the biennium ended June 30, 2007 were to provide reliable, audited financial statements and to answer the following questions:

1. What are the highest risk areas of the Department of Transportation's operations and is internal control adequate in these areas?
2. What are the significant and high-risk areas of legislative intent applicable to the Department of Transportation and are they in compliance with these laws?
3. Are there areas of the Department of Transportation's operations where we can help to improve efficiency or effectiveness?

Audit Scope

This audit of the Department of Transportation for the biennium ended June 30, 2007 was conducted in accordance with *Government Auditing Standards*, issued by the Comptroller General of the United States. To meet the objectives outlined above, we:

Audit Methodology

- Prepared financial statements from the legal balances on the state's accounting system tested as part of this audit and the audit of the state's Comprehensive Annual Financial Report and developed a discussion and analysis of the financial statements.
- Performed detailed analytical procedures for expenditures and receipts.
- Tested samples of expenditures and correcting entries.
- Reviewed prior year audit workpapers.
- Interviewed appropriate agency personnel.
- Reviewed Department of Transportation written plans and applicable manuals.
- Reviewed Department of Transportation's biennial report.
- Observed Department of Transportation's processes and procedures.
- Reviewed North Dakota Century Code Title 24, other agency applicable NDCC, and the 2005 Session Laws.
- Reviewed industry best practices through the use of Internet searches.
- Visited Department of Transportation district offices to review inventory control procedures and capital assets.
- Searched for recent studies or reports relating to the Department of Transportation.

Discussion and Analysis

The accompanying financial statements have been prepared to present the Department of Transportation's revenues and expenditures on the legal (budget) basis. The accompanying financial statements are not intended to be presented in accordance with generally accepted accounting principles.

For the biennium ended June 30, 2007, operations of the Department of Transportation were primarily supported by appropriations from federal and special revenue funds.

FINANCIAL SUMMARY

The Department of Transportation's capital assets include land, buildings, equipment, infrastructure assets, and construction in progress all of which are initially capitalized at historical cost. All capital assets with an original cost of \$5,000 (\$100,000 or more for infrastructure) or more per unit and an estimated useful life in excess of one year are capitalized. The Department of Transportation's total assets before deducting accumulated depreciation for fiscal years ended June 30, 2007 and 2006 were approximately \$3.3 billion and \$3.2 billion, respectively. The largest category for the Department of Transportation is infrastructure. Major infrastructure assets are major statewide public systems such as freeways, freeway lighting systems, freeway drainage systems, freeway signs, bridges, bridge lighting systems, etc. Infrastructure capitalized by the Department of Transportation before deducting accumulated depreciation for fiscal years June 30, 2007 and June 30, 2006 was approximately \$2.8 billion and \$2.7 billion, respectively.

Revenue consisted primarily of federal funds, taxes, licenses, permits, fees, bond revenue, political subdivision payments, driver's license, sale of capital assets, and interest earnings. These types of revenue make up approximately 99% of all the Department of Transportation revenue. Total revenue was \$545,070,112 for fiscal year ended June 30, 2007 as compared to \$563,430,025 for the fiscal year ended June 30, 2006. The largest source of revenue is intergovernmental revenue, which is primarily federal revenue and also includes fleet services. Intergovernmental revenue decreased approximately \$22 million during fiscal year 2007 compared to the prior fiscal year. The amount of federal dollars is dependent on the number of projects the Department of Transportation is working on, as well as the cost and timing of the project that will be reimbursed by the federal government.

The second largest source of revenue for the Department of Transportation is taxes. Tax revenue for fiscal year 2007 was approximately \$175 million, compared to approximately \$170 million for fiscal year 2006. The tax category consists primarily of motor fuel tax, motor vehicle excise tax, and special fuel tax. The revenue for fuels taxes are dependent on the taxes deposited into the highway tax distribution fund each month.

Licenses, permits, and fees decreased from fiscal year 2006 to 2007 by approximately \$10 million or 14%. This category includes all of the related motor vehicle license and dealer fees, pro-rata fees, public transportation fees, single state registration fees, and veteran's cemetery plates. The revenue for license, permits, and fees is mostly dependent upon the vehicle and dealer registrations as well as single state registrations.

The Department of Transportation is authorized pursuant to North Dakota Century Code 24-02 to issue grant and revenue anticipation bonds for the purpose for financing certain qualified federal aid transportation projects. Bond revenue increased from fiscal year 2006 to 2007 by approximately \$5.8 million or 46%. Bond revenue is dependent on projects the Department of Transportation is working on as well as the cost and timing of the projects.

Revenue from political subdivisions (cities and counties) was approximately \$17.6 million and \$13.4 million for fiscal years 2007 and 2006, respectively. Political subdivision revenue increased from fiscal year 2006 to 2007 by approximately \$4 million. The amount of revenue received from political subdivision is dependent on the number of projects the Department of Transportation is working on, as well as the cost and timing of the project.

Other revenue remained fairly constant for the Department of Transportation, decreasing slightly.

Total expenditures for the Department of Transportation were \$426,023,526 for the year ended June 30, 2007 as compared to \$450,079,681 for the prior year. The decrease in total expenditures for the audited period is reflected primarily in contractor payments (which also account for 61% of total expenditures in both years). Contractor payments are dependent on the number of projects the Department of Transportation is working on, as well as the cost and timing of the project. The increase in salaries and benefits from fiscal year 2006 to 2007 reflected the general salary increases and increase in benefit costs. Buildings, grounds, and vehicle supplies decreased by approximately \$5 million or 21% due to less contract patching during fiscal year 2007. Professional services decreased from fiscal year 2006 to fiscal year 2007 by approximately \$4 million or

25%. The decrease in professional services was due to less engineer services required for the projects the Department of Transportation was working on at the time then in the previous year. All other expenditures remained fairly constant.

ANALYSIS OF SIGNIFICANT VARIANCES BETWEEN FINAL BUDGETED AND ACTUAL EXPENDITURES

The Department of Transportation's (DOT) appropriation was originally approved at approximately \$955 million. The appropriation was increased by approximately \$15.6 million through approved appropriation adjustments to a total of approximately \$970.6 million. The largest increase in the appropriation was for highways or capital improvements in the amount of approximately \$9 million. The DOT expended approximately \$876 million for the biennium, leaving approximately \$95 million of unexpended appropriation. The largest unexpended portion of the appropriation was for highways or capital improvements in the amount of \$91 million or approximately 96% of the total. The unexpended appropriation for highways or capital improvements was for improvements not started or completed at the close of the biennium ended June 30, 2007. These capital improvements were budgeted for in the new biennium (2007–2009). The drivers and vehicle services line item was over expended by \$131,559. DOT was aware of the potential of over expending the appropriation line for drivers and vehicles services and requested \$250,000 from the Emergency Commission. However, the amount requested was not enough to offset the total. The remaining operating appropriation was largely due to unexpended funding for operating expenses and grants for capital projects that had not been started or were not completed. These types of expenditures, where applicable, are budgeted for in the subsequent biennium.

Financial Statements

STATEMENT OF REVENUES AND EXPENDITURES

	June 30, 2007	June 30, 2006
<u>Revenues and Other Sources:</u>		
Intergovernmental Revenue	\$260,429,551	\$282,871,644
Taxes	174,605,165	169,977,857
Licenses, Permits, and Fees	63,009,534	73,352,867
Bond Revenue	18,418,549	12,644,413
Political Subdivisions	17,636,139	13,373,505
Drivers License and Fees	4,035,024	4,188,926
Sale of Capital Assets	2,159,426	2,709,258
Interest Earnings	2,070,076	1,466,707
Highway Damage Claims	922,980	401,700
Publication Sales and Other Services	564,624	383,632
Miscellaneous	520,513	1,067,903
Transfer In	698,531	991,613
Total Revenues and Other Sources	\$545,070,112	\$563,430,025
<u>Expenditures and Other Uses:</u>		
Salaries and Benefits	\$57,180,044	\$55,262,316
Major Operating Expenditures:		
Building, Grounds, Vehicle Supply	19,629,463	24,895,575
Professional Services	13,494,646	17,932,560
Travel	13,182,156	13,364,622
Repairs	6,527,966	6,270,242
Data Processing Charges and Software	4,448,320	4,251,319
Utilities	1,989,398	1,970,385
Miscellaneous Supplies	1,528,793	1,792,342
Insurance	920,344	911,413
Postage	792,943	717,490
Other Operating Expenses	2,732,060	3,555,350
Contractor Payments	260,829,063	275,708,466
Grants, Benefits, and Claims	19,171,641	20,484,436
Motor Vehicles	12,981,308	15,445,986
Land and Buildings	5,600,297	3,433,927
Equipment	2,844,529	1,532,802
Extraordinary Repairs	1,002,791	1,698,017
Transfers Out	1,167,764	852,433
Total Expenditures and Other Uses	\$426,023,526	\$450,079,681

STATEMENT OF APPROPRIATIONS

For The Biennium Ended June 30, 2007

Expenditures by Line Item:	<u>Original Appropriation</u>	<u>Adjustments</u>	<u>Final Appropriation</u>	<u>Expenditures</u>	<u>Unexpended Appropriation</u>
Administration	\$ 27,258,829		\$ 27,258,829	\$ 22,962,918	\$ 4,295,911
Drivers & Vehicle Services	20,102,818	\$ 250,000	20,352,818	20,484,377	(131,559)
Highways	864,359,565	9,233,834	873,593,399	782,890,712	90,702,687
Fleet Services	43,287,136	6,096,314	49,383,450	49,307,599	75,851
Totals	<u>\$955,008,348</u>	<u>\$15,580,148</u>	<u>\$970,588,496</u>	<u>\$875,645,606</u>	<u>\$94,942,890</u>
Expenditures by Source:					
Federal Fund	\$540,175,593	\$ 326,260	\$540,501,853	\$530,789,918	\$ 9,711,935
Special Funds	414,832,755	15,253,888	430,086,643	344,855,688	85,230,955
Totals	<u>\$955,008,348</u>	<u>\$15,580,148</u>	<u>\$970,588,496</u>	<u>\$875,645,606</u>	<u>\$94,942,890</u>

Appropriation Adjustments:

The \$250,000 adjustment to the Drivers and Vehicle Services line item was approved by the Emergency Commission. This increase gave NDDOT spending authority to accept National Highway Traffic Safety Administration funds to provide additional traffic safety programs.

\$9,157,574 and \$2,096,314 adjustments to the Highways, and the Fleet Services line items were approved by the Capital Construction Carryover Committee.

A \$76,260 adjustment to the Highways line item was approved by the Emergency Commission. This increase gave NDDOT spending authority to accept US Department of Transportation funds to fund the Safe Routes to School Program.

A \$4,000,000 adjustment to Fleet Services line item was approved by the 2007 Legislative Assembly as an emergency measure for fleet services motor vehicle purchases.

Expenditures Without Appropriations Of Specific Amounts:

Insurance recoveries has a continuing appropriation authorized by NDCC section 54-44.1-09.1 (\$242,957 of expenditures for this biennium).

The Drivers License Trust Fund is authorized by NDCC 39-16-10 to account for cash received and to make payments and refunds to/from a motor vehicle operators involved in accidents that have no automobile liability policy (\$23,500 of payments and refunds for this biennium).

Internal Control

In our audit for the biennium ended June 30, 2007, we identified the following areas of the Department of Transportation's internal control as being the most important:

Internal Controls Subjected To Testing

- Controls surrounding the processing of revenues.
- Controls surrounding the processing of expenditures.
- Controls effecting the safeguarding of assets.
- Controls relating to compliance with legislative intent.
- Controls surrounding the ConnectND (PeopleSoft) system.
- Controls surrounding the computer-based vehicle registration and titling system, driver's license master file, construction automated records system, motor pool billing, and motor carrier online system.

We gained an understanding of internal control surrounding these areas and concluded as to the adequacy of their design. We also tested the operating effectiveness of those controls we considered significant. We concluded that internal control was not adequate noting certain matters involving internal control and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of internal control that, in our judgment, could adversely affect the Department of Transportation's operations or ability to record, process, summarize, and report financial data consistent with the assertions of management in financial statements. Reportable conditions are described below. We also noted other matters involving internal control that we have reported to management of the Department of Transportation in a management letter dated April 9, 2008.

Finding 07-1

COMPUTER ACCESS CONTROLS WEAKNESS

Access controls over ConnectND Finance, Human Resource Management System (HRMS), Motor Pool, and Drivers License systems are not adequate.

Proper internal controls, as documented in the Committee of Sponsoring Organizations (COSO) of the Treadway Commission's *Internal Control - Integrated Framework*, include limiting access to computer systems to only individuals that need access for their job duties. The following weaknesses were noted:

- Several individuals have the ability to both process and approve transactions.
- Several individuals have access to systems beyond what was required for their job duties.
- Former employees still have access to certain systems.
- Several Highway Patrol employees have access to change usage transactions of other agencies in the Motor Pool billing system.

Policies and procedures should be in place to ensure: individuals only have access necessary to perform their job duties; an individual is assigned the responsibility of controlling access to all applications; and ongoing reviews are performed to ensure access rights are properly maintained. Without these controls, there is an increased likelihood of unauthorized access to confidential or sensitive information and fraud.

Audit Recommendation
and Agency Response

Recommendation:

We recommend the Department of Transportation:

1. Establish policies and procedures to restrict access privileges to only necessary individuals.
2. Assign ongoing responsibility for security for each information technology application.
3. Perform continuing reviews of access privileges.

Department of Transportation Response:

We concur with the finding. The recommendations as set forth by the State Auditor's Office will be implemented.

MOTOR VEHICLE DIVISION BANK RECONCILIATION

The Department of Transportation (DOT) is not properly reconciling their motor vehicle clearing account to the report of amounts processed and pending each month. Due to a coding error in the Single State Registration System, DOT improperly transferred \$2.3 million from their motor vehicle clearing account to the Highway Fund from 2000-2007. DOT noticed the error and correctly transferred the money back to their clearing account in June 2007. Had the clearing account been properly reconciled, this coding error would have been detected promptly.

We also noted that DOT did not properly complete their Cash and Investments Summary Form closing package. This form is required by the Office of Management and Budget in preparing the state's Comprehensive Annual Financial Report (CAFR). On that form, DOT reported their entire unrecorded Bank of North Dakota cash balance in the Highway Fund. However, a material portion of the \$14 million unrecorded cash reported as belonging to the Highway Fund should have been allocated to other funds. Had the errors not been detected, it would have resulted in the state's financial statements being materially misstated.

Audit Recommendation
and Agency Response

Recommendations:

We recommend the Department of Transportation:

- 1) Properly reconcile their motor vehicle clearing account to the report of amounts processed and pending each month.
- 2) Properly complete their Cash and Investments Summary Form.

Department of Transportation Response:

We concur with the finding. The State Auditor's recommendations have already been substantially implemented.

INTERNAL AUDIT FUNCTION

The Department of Transportation is not adequately monitoring its internal control system as a result of the Internal Audit Services Division's shift in focus over the last several years towards non-internal audit functions. They primarily review federally-mandated annual motor carrier registrations and conduct on-site reviews of the inventory procedures at their district sites. The Internal Audit Services Division did not compile a risk-based analysis and annual work plan to allow the Audit Committee to properly determine the most efficient use of internal audit resources. In addition, the Internal Audit Services Division still reports to the Director of the Financial Management Division.

According to the Committee of Sponsoring Organizations of the Treadway Commission (COSO) Internal Control – Integrated Framework, internal control consists of five interrelated components. One of the components is monitoring and that internal control systems need to be monitored through a process that assesses the quality of the system's performance over time. Monitoring can be accomplished through ongoing monitoring activities, separate evaluations, or a combination of the two. COSO also identifies the roles and responsibilities individuals within an entity have in effecting internal control. Internal auditors' roles and responsibilities are to directly examine internal controls and recommend improvements. COSO cites the Standards established by the Institute of Internal Auditors by stating that the scope of internal auditing should encompass the examination and evaluation of the adequacy and effectiveness of the organization's system of internal control and the quality of performance in carrying out assigned responsibility.

Audit Recommendation and Agency Response

Recommendations:

We recommend the Internal Audit Services Division:

- Change their scope to encompass the examination and evaluation of the adequacy and effectiveness of the organization's system of internal control and the quality of performance in carrying out assigned responsibility.
- Compile a risk-based analysis and annual work plan to be presented to and approved by the Audit Committee to properly determine the most efficient use of internal audit resources.
- Report their audit results and findings directly to the Audit Committee.

Department of Transportation Response:

We concur with the finding. The State Auditor's recommendations will be incorporated into NDDOT's action plan for the internal audit function.

As noted in the audit finding, the NDDOT auditors primarily conduct federally mandated reviews of third parties. The volume of these mandated reviews has increased to the point that virtually all available NDDOT audit resources are expended on them. NDDOT management is well aware of the necessity and benefits of an audit function that is focused on internal activities and we strongly support this concept.

The NDDOT must continue to meet its federally mandated review obligations. Therefore, successful implementation of an effective internal audit function will require additional resources beyond those currently available. The department will pursue additional resources as a part of the 2009-2011 biennium budget request.

The NDDOT will also take the following steps to restore an effective internal audit function:

- The department will assign additional audit staff and/or funds to outsource additional audit activities at a level that will enable the department to continue meeting the federally mandated review obligations and carry out an effective internal audit function.*
- An audit committee will be reestablished. The committee will be responsible for reviewing and approving the annual work plan for the audit function, reviewing and approving staffing and other resource levels necessary to achieve the annual work plan, and reviewing and approving the findings and recommendations resulting from the internal audit activities.*
- The audit unit will conduct or contract for a risk based analysis, the results of which will be incorporated into the annual work plan for the audit unit.*
- The department's audit unit will no longer report directly to the Financial Management Director (i.e. the department's chief financial officer) on matters involving audit activities. Rather, it will report to the Deputy Director for Business Support and the department's audit committee. This action is being implemented to avoid potential situations that could result in a conflict of interest and in accordance with the State Auditor's recommendation.*
- The department's audit policies will be rewritten to encompass these improvements.*

Compliance With Legislative Intent

In our audit for the biennium ended June 30, 2007, we identified and tested Department of Transportation's compliance with legislative intent for the following areas that we determined to be significant and of higher risk of noncompliance:

Legislative Intent Subjected To Testing

- Determined DOT was in compliance with NDCC section 24-02-10 by properly completing the biennial report.
- Determined DOT was in compliance with NDCC section 24-02-37 by properly depositing moneys in the Highway Fund in an interest bearing account at the Bank of North Dakota and depositing 40% of the income from this account into the Special Road Fund.
- Determined DOT was in compliance with NDCC section 24-02-41 by properly depositing the required revenue into the Highway Fund.
- Determined DOT was in compliance with NDCC section 24-02-35.2 by properly depositing revenue from the sale of road materials into the Department of Transportation Fund.
- Determined that DOT was in compliance with NDCC section 24-02-43 by properly depositing proceeds correctly into the State Infrastructure Bank.
- Determined DOT was in compliance with NDCC section 24-03-15 by properly depositing proceeds from the sale of obsolescent highway equipment to the fund from which the original purchase was made.
- Determined DOT is in compliance with NDCC section 26.1-23-03 by properly suspending the additional registration fee of \$1.00 in the succeeding year if the amount of uncommitted money in the Unsatisfied Judgment Fund is \$150,000 or more as of June 1 of any year.
- Determined that DOT was in compliance with NDCC section 48-01.2-13 by properly applying the allowance and payment of estimates for the construction of public buildings by retaining 10% of the estimated completion total until the project was 50% completed.
- Determined DOT was in compliance with NDCC section 48-02-07 by properly applying the allowance and payment of estimates for the construction of public buildings by retaining 10% of the estimated completion total until the project is 50% completed.
- Determined DOT was in compliance with NDCC section 24-02-25 by properly applying the retainage policy of retaining 4% of the amount of work done to date until the project is 50% completed.

- Determined the proper DOT Motor Vehicle fees were collected and deposited correctly for the following:
 - NDCC section 39-04-39 for license fees in the registration fund in excess of the amount required for operating expenses to be transferred to the Highway Tax Distribution Fund.
 - NDCC section 39-05-30 for fees and revenues received under this chapter of the code.
 - NDCC section 39-12-02(3) collections by the North Dakota Highway Patrol for special permits for vehicles of excessive size and weight were being deposited into the highway fund.
 - NDCC section 39-12-04.1 for seasonal permits for moving fertilizer, chemical applicators, and for hauling bales.
 - NDCC section 39-12-20 for amounts equal to the charges assessed pursuant to NDCC 39-12-17 for sales of assets to cover the cost of excess of weight limitations.
 - NDCC section 39-22-05 for requiring the surety bond of \$25,000 before motor vehicle dealer's licenses are issued.
 - NDCC section 39-22-05.1 for registration fees for motor vehicle dealer licenses.
 - NDCC section 39-24-09.1 for snowmobile trail tax.
 - NDCC section 39-26-11 for investment earnings on the Abandoned Motor Vehicle Disposal Fund.
 - NDCC section 39-26-12 by suspending motor vehicle tax if the amount of uncommitted money in the abandoned motor vehicle disposal fund is \$250,000 or more.
 - NDCC section 39-29-10 for all-terrain vehicles fee and trail tax.
 - NDCC section 54-01.1-03 for payment to displaced person for actual reasonable moving expenses.
 - NDCC section 57-40.3-02 by charging the motor vehicle excise tax of 5%.
 - NDCC section 57-39.2-26.1 by properly calculating the allocation for State Aid Distribution.
 - NDCC section 57-40.3-10 by properly transferring the motor vehicle excise tax revenue to the State Treasurer to be credited to the general fund.
 - NDCC sections 57-40.4-02 and 57-40.4-03 by properly issuing the correct refunds.
- Determined that proper payments and refunds were made in accordance with NDCC section 39-16-10.3.
- Determined that DOT was in compliance with NDCC sections 39-06-03 and 39-06-17 by properly issuing drivers licenses to drivers aged 14 to 16.

- Determined DOT was in compliance with NDCC sections 39-26-11, 39-01-15(5), 39-24-05, 37-03-14, and 39-24-09(1) by properly not expending monies out of the shared funds.
- Determined DOT was in compliance with NDCC section 57-27-19 and NDCC section 57-39.2-26.1 by properly not expending monies out of the distribution funds.
- The proper use of funds for fund 200 (Highway Fund) to account for revenues and expenditures associated with the general operations of the DOT NDCC chapter 24-02), fund 201 (Motor Vehicle Fund) revenues and expenditures associated with general operations of Motor Vehicle NDCC chapter 24-02, fund 217 (Dealer Enforcement Fund) fees from new and used motor vehicle dealer registrations are deposited correctly, fund 225 (State Infrastructure Bank) for funding of eligible projects as determined by agreement of members of the multi-state infrastructure bank (NDCC chapter 24-02), fund 230 (Special Road Fund) used for the construction and maintenance of access roads and roads within recreational, tourist, and historical areas (NDCC 24-02), fund 232 (Public Transportation Fund) fees are properly deposited into the fund, fund 277 (State Rail Fund) used for loans made to improve railroad junctions, load out facilities, etc., fund 406 (Drivers License Trust Fund) receiving funds from uninsured drivers involved in accidents, and fund 949 (DOT Debt Service Fund) for accounting for the accumulation of resources for and the payment of principal and interest on bonds issued by the DOT.
- Proper use of the State Treasurer (State Constitution, article X, section 12).
- Compliance with appropriations and related transfers (2005 North Dakota Session Laws chapter 40).
- Compliance with OMB's Purchasing Procedures Manual.
- Travel-related expenditures are made in accordance with OMB policy and state statute.
- Proper use of outside bank accounts, petty cash funds and proper authority for investments outside the Bank of North Dakota.
- Adequate blanket bond coverage of employees (NDCC section 26.1-21-08).
- Compliance with fixed asset requirements including record keeping, surplus property, lease and financing arrangements in budget requests, and lease analysis requirements.
- Compliance with payroll related laws including statutory salaries for applicable elected and appointed positions, and certification of payroll.

The results of our tests disclosed one instances of noncompliance that is required to be reported under *Government Auditing Standards*. This finding is described below. Other than this finding, we concluded there was compliance with legislative intent indentified above. We also noted certain inconsequential instances of noncompliance that we have reported to management of the Department of Transportation in a management letter dated April 9, 2008.

OVERSPENDING APPROPRIATION AUTHORITY

Finding 07-4

The Department of Transportation (DOT) overspent their Drivers and Vehicle Services line item by \$131,559 during the 2005-2007 biennium. DOT was aware of the potential of overspending the line item and received an additional \$250,000 of spending authority approved by the Emergency Commission in June 2007. However, after receiving the additional spending authority, they still overspent their line item by \$131,559.

North Dakota Century Code (NDCC) Section 54-16-03 states that it is unlawful to expend more than appropriated. As a result, the Department of Transportation is not in compliance with NDCC.

Audit Recommendation and Agency Response

Recommendation:

We recommend that the Department of Transportation develop control procedures to ensure they do not overspend their appropriation authority in accordance with NDCC section 54-16-03.

Department of Transportation Response:

We concur with the finding and will fully implement the auditor's recommendation.

This over expenditure of appropriation resulted primarily from an over commitment of federal funds for traffic safety grant activities by the Drivers License and Traffic Safety Division (DLTS) of the NDDOT. As such, the federal funds were available to cover the related costs; however, the department did not have adequate appropriation authority available to carry out that level of activity in the 2005-2007 biennium. As noted by the State Auditor's Office, NDDOT was aware of the potential for overspending this appropriation and did address the issue with the Emergency Commission. Unfortunately, the DLTS calculation of outstanding commitments was too low; as a result, our Emergency Commission request was likewise inadequate. While the department did over expend the Driver and Vehicle Services program appropriation, it should be noted that the NDDOT did not

over expend the total of its entire program appropriations; the department had a positive biennium ending balance for all appropriations when considered in total.

Since this occurrence, the department has taken several steps to insure tighter controls over DLTS spending, including the following:

- A business manager position has been created within the DLTS division. This position is staffed by an individual possessing significantly greater fiscal skills than previously available within the DLTS division. This position will be responsible for insuring that contract commitments are in line with available federal revenue and appropriation authority and for monitoring, coordinating, and communicating expectations and results with DLTS management and program staff, NDDOT executive management staff, and NDDOT fiscal staff.*
- NDDOT executive management has strongly reemphasized to DLTS management the importance of a high level of fiscal responsibility, integrity, and quality on their part. Also, the necessity for compliance with NDDOT executive and fiscal management directives has been strongly reemphasized.*
- The NDDOT is no longer operating under a program budget concept. Rather, it now operates under a traditional appropriation line budget. While this change in no way modifies NDDOT's responsibility for staying within the appropriate appropriation boundaries, it does provide an effective mechanism to easily remedy some appropriation difficulties that may otherwise be encountered in a smaller, program based budget. Had the agency been operating under a traditional appropriation line budget during the 2005-2007 biennium, it is quite likely that the NDDOT would have been able to transfer funds internally and still remain within the appropriation line constraints.*

Operations

This audit did not identify areas of the Department of Transportation's operations where we determined it was practical at this time to help to improve efficiency or effectiveness.

Prior Recommendations Not Implemented

The following prior recommendation was not implemented:

Finding 05-1

INTERNAL AUDIT FUNCTION

Background

The Department of Transportation is not adequately monitoring its internal control system as a result of the Internal Audit Services Division's shift in focus over the last several years towards conducting primarily external audits, as mentioned in the prior audit's operational improvement. The Internal Audit Services Division did not compile a risk-based analysis and annual work plan to allow the Audit Committee to properly determine the most efficient use of internal audit resources. In addition, the Internal Audit Services Division still reports to the Director of the Financial Management Division.

Recommendation

We recommend the Department of Transportation:

- Require the Internal Audit Services Division to compile a risk-based analysis and annual work plan to be presented to and approved by the Audit Committee to allow the Audit Committee to properly determine the most efficient use of internal audit resources.
- Internal audit scope include documented assessments of policies and internal control systems of financial and operational information in order to promote continuous improvement.
- Allow the Audit Committee to decide which audit results and findings should be presented to the Committee. The Audit Committee may grant the Financial Management Division responsibility for reviewing those results not relating to the internal controls, policies and procedures of the agency.

Status

Not Implemented. This finding is readdressed on page 16.

Management Letter (Informal Recommendations)

April 9, 2008

Mr. Francis Ziegler, Director
Department of Transportation
State Capitol
608 E Boulevard Avenue
Bismarck, ND 58505-0700

Dear Mr. Ziegler:

We have performed an audit of the Department of Transportation for the biennium ended June 30, 2007, and have issued a report thereon. As part of our audit, we gained an understanding of the Department of Transportation's internal control structure to the extent we considered necessary to achieve our audit objectives. We also performed tests of compliance as described in the same report.

Our audit procedures are designed primarily to enable us to report on our objectives including those related to internal control and compliance with laws and regulations and may not bring to light all weaknesses in systems and procedures or noncompliance with laws and regulations which may exist. We aim, however, to use our knowledge of your organization gained during our work to make comments and suggestions which we hope will be useful to you.

In connection with the audit, gaining an understanding of the internal control structure, and tests of compliance with laws and regulations referred to above, we noted certain conditions we did not consider reportable within the context of your audit report. These conditions relate to areas of general business practice or control issues that have no significant bearing on the administration of federal funds. We do, however, want to present our recommendations to you for your consideration and whatever follow-up action you consider appropriate. During the next audit we will determine if these recommendations have been implemented, and if not, we will reconsider their status as non-reportable conditions.

The following present our informal recommendations.

CASH

Informal Recommendation 07-1: Finance Division Refunds

We recommend the Department of Transportation include proper supporting documentation for refunds and ensure proper coding of transactions.

ACCOUNTS PAYABLE/EXPENDITURES

Informal Recommendation 07-2: Motor Vehicle Division Refunds

We recommend the Department of Transportation Motor Vehicle Division ensure refunds are paid to the proper individual.

Informal Recommendation 07-3: Purchase Card Process

We recommend the Department of Transportation:

- Ensure the individual reconciling the monthly individual purchase statements to the Strategic Account Management database transaction detail report sign off on the reconciliation; and
- Comply with Office of Management and Budget policy by ensuring an appropriate individual performs the responsibility of the reviewer.

PAYROLL

Informal Recommendation 07-4: One Time Payment Query

We recommend the Department of Transportation assign the responsibility of generating the monthly one-time payment query in PeopleSoft HRMS to someone who has inquiry rights only and have this report approved by someone authorized to approve payroll.

Informal Recommendation 07-5: Change of Status Form Reconciliation

We recommend the Department of Transportation ensure the individual responsible for reconciling approved change of status forms to PeopleSoft does not have access to process changes.

LEGISLATIVE INTENT

Informal Recommendation 07-6: North Dakota Century Code Fund References

We recommend the Department of Transportation:

- Initiate legislation to change NDCC 39-04-39, NDCC 39-05-30, NDCC 39-04-39.3, NDCC 39-04-19 (1), and NDCC 39-04-19 (7) to state the fees and revenues referred to are deposited into the correct fund and that NDCC reflect the fund from which salaries and other expenses are actually paid.
- Initiate legislation to change NDCC 39-16-10 (3) to reflect current procedures.

Informal Recommendation 07-7: Administrative Code

We recommend the Department of Transportation update their Administrative Code and eliminate any unnecessary areas.

Informal Recommendation 07-8: Shadow Systems

We recommend the Department of Transportation request approval from the ConnectND Steering Committee to maintain the Non-Capitalized Asset Tracking System and the Information Technology Service Management Systems.

Informal Recommendation 07-09: Reimbursement For Meals

We recommend the Department of Transportation's management and supervisors only approve meals for reimbursement in accordance with the Office of Management and Budget's travel policy.

GENERAL

Informal Recommendation 07-10: Establishing Adequate Fraud Programs and Controls

We recommend the Department of Transportation develop adequate policies and procedures relating to:

- Establishing a formal systematic risk assessment process which includes a thorough fraud risk assessment;
- Designing and documenting the necessary control activities to ensure each significant fraud exposure identified during the risk assessment process has been adequately mitigated; and
- Establishing a comprehensive code of conduct including ensuring employees has acknowledged their receipt and reading of the code of conduct.

Management of the Department of Transportation agreed with these recommendations.

I encourage you to call myself or an audit manager at 328-2241 if you have any questions about the implementation of recommendations included in your audit report or this letter.

Sincerely,

Orlin Bensen
Senior Auditor